

Internal Revenue Service

Number: **201516009**

Release Date: 4/17/2015

Index Numbers: 1362.01-00, 1362.01-01,
1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B3
PLR-123176-14

Date:
November 12, 2014

Legend

X =

Y =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear :

This letter responds to a letter dated June 10, 2014, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. X was the sole shareholder of Y on Date 2. X elected to be an S corporation and to treat Y as a qualified subchapter S subsidiary (QSub) effective Date 2. However, some of X's shareholders failed to consent properly to X's S corporation election. The trustees of Trust 1 and Trust 2 (qualified subchapter S trusts (QSSTs) pursuant to § 1361(d)(1)), and not the beneficiaries of Trust 1 and Trust 2, executed X's Form 2553, Election by a Small Business Corporation, on behalf of Trust 1 and Trust 2. Additionally, the trustee of Trust 3 (a trust described under § 1361(c)(2)(A)(i)), and not the grantor of Trust 3, executed X's Form 2553 on behalf of Trust 3. Therefore, Trust 1, Trust 2 and Trust 3 did not consent properly to X's S corporation election. Accordingly, X's S corporation election and Y's QSub election were ineffective.

In addition, Trust 4, a trust that was treated under subpart E of part I of subchapter J of chapter 1 of the Code as entirely owned by A, was an eligible shareholder of X under § 1361(c)(2)(A)(i). On Date 3, A died. Under § 1361(c)(2)(A)(ii), Trust 4 remained an eligible shareholder until Date 4. The trustees of Trust 4 intended to transfer X stock to Trust 5 on or before Date 4. However, the trustees did not transfer X stock to Trust 5 until Date 6. Accordingly, Trust 4 ceased to be an eligible shareholder of X on Date 5. Therefore, X's S corporation election and Y's QSub election, had they been valid on Date 2, terminated on Date 5. On Date 6, Trust 4 transferred its shares of X stock to Trust 5. It is represented that Trust 5 is a QSST, a permissible shareholder of an S corporation, and that the beneficiary of Trust 5 filed a QSST election effective Date 6.

X represents that there was no tax avoidance or retroactive tax planning involved in the failure of Trust 1, Trust 2 and Trust 3 to properly execute X's Form 2553 and in

the failure of Trust 4 to timely transfer the shares of X to Trust 5. It is represented that X and its shareholders have treated X as an S corporation and Y as a QSub since Date 2. In addition, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation and Y as a QSub as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term “small business corporation” means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of this title (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that, for purposes of § 1361(b)(3)(B), the term “qualified subchapter S subsidiary” means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)) if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made. Section

1361(d)(2)(A) provides that a beneficiary of a QSST may elect to have § 1361(d)(1) apply.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) is terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (i) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (ii) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, or to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election and Y's QSub election were ineffective on Date 2 as a result of the improper consents to X's S corporation election. We further conclude that the ineffectiveness of X's S corporation election and Y's QSub election constituted inadvertent invalid elections within the meaning of § 1362(f). In addition, because X had an ineligible S corporation shareholder on Date 5, we conclude that X's S corporation election and Y's QSub election would have terminated on Date 5 had X's S corporation election been effective on Date 2. We further conclude that the terminations of X's S corporation election and Y's QSub election on Date 5 were inadvertent within the meaning of § 1362(f). Consequently, under § 1362(f), X will be treated as an S corporation from Date 2 and thereafter provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Furthermore, Y will be

treated as a QSub of X from Date 2 and thereafter, provided that the QSub election was otherwise valid and not otherwise terminated.

As a condition of the rulings, the beneficiaries of Trust 1 and Trust 2 and the grantor of Trust 3 must each sign a written statement as described in § 1.1362-6(b)(1) consenting to X's S corporation election effective Date 2. The written statement(s) must be filed with the appropriate service center within 120 days from the date of this letter, indicating that the statement(s) are to be associated with X's originally filed Form 2553.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was otherwise a valid S corporation and whether Y was otherwise a valid QSub.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited for precedent.

Pursuant to a power of attorney on file, we are sending a copy of this letter to X's authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the rulings requested, it is subject to verification on examination.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for §6110 purposes

cc: